

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Chan, et al. Analyst: Rachel Coco Bill Number: AB 1815
Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: January 15, 2004
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: PIT Rates/Increase Maximum Rates To 10% And 11% And Alternative Minimum Tax Rate To 8.5%

SUMMARY

This bill would increase the top personal income tax (PIT) rate from 9.3% to 10% and 11% and would increase the alternative minimum tax (AMT) rate from 7% to 8.5%.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to restore the higher tax rates to address the current budget shortfall.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The bill states that it would be operative for taxable years beginning on or after January 1, 2005, and before January 1, 2010.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law imposes five different income tax rates on individuals ranging from 15% to 35%. Existing state law imposes six different PIT rates ranging from 1% to 9.3%. Each tax rate applies to a different level of income known as a "tax bracket." Existing state law requires the Franchise Tax Board (FTB) to recompute the tax brackets each year based on the change in the California Consumer Price Index (CPI).

Federal law provides a personal AMT rate ranging from 26% to 28%. Existing state law provides a personal AMT rate of 7%. A taxpayer with substantial income can use preferential tax benefits, such as exclusions, deductions, and credits, to reduce their income tax liability. AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ <input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

2/3/04

THIS BILL

This bill would establish a PIT rate of 10% for:

- Single filers (including married filing separate) whose taxable income is over \$142,184;
- Joint filers whose taxable income is over \$284,368; and
- Head of household filers whose taxable income is over \$193,534.

This bill also would establish a PIT rate of 11% for:

- Single filers (including married filing separate) whose taxable income is over \$284,368;
- Joint filers whose taxable income is over \$568,737; and
- Head of household filers whose taxable income is over \$387,068.

Note: the bracket amounts above were by calculated by applying the annual consumer price index (CPI) growth to the 1991 tax brackets.

For example:

Preliminary 2005 Tax Brackets And Rates For Single Filers				2005 Tax Brackets And Rates For Single Filers As Proposed			
\$0	-	\$6,316	1.0%	\$0	-	\$6,316	1.0%
\$6,316	-	\$14,975	2.0%	\$6,316	-	\$14,975	2.0%
\$14,975	-	\$23,634	4.0%	\$14,975	-	\$23,634	4.0%
\$23,634	-	\$32,808	6.0%	\$23,634	-	\$32,808	6.0%
\$32,808	-	\$41,462	8.0%	\$32,808	-	\$41,462	8.0%
\$41,462	-	and over	9.3%	\$41,462	-	142,184	9.3%
				\$142,184	-	\$284,368	10%
				\$284,368	-	And over	11%

Note: The 2005 tax bracket amounts are not known at this time due to the annual indexing adjustment. To estimate the 2005 bracket amounts, a CPI of 2.1% was applied to the 2003 bracket amounts to get the 2004 bracket amounts. A CPI of 2.7% was then applied to the 2004 brackets in order to approximate the 2005 brackets.

This bill also provides that the 10% and 11% brackets would be adjusted annually for inflation.

In addition, this bill would increase the AMT rate to 8.5% for individual taxpayers.

This bill specifies that the increased tax bracket amounts of 10% and 11% and the increased AMT rate of 8.5% would apply to taxable years beginning on or after January 1, 2005, and before January 1, 2010. After that date, the top tax bracket would revert to the previous amount of 9.3% and the AMT rate would revert back to 7%.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATION

Amendment 1 is provided in order to make a technical correction.

LEGISLATIVE HISTORY

AB 4 (Chan, 2003) and SB 1255 (Burton, 2002) contained language similar to the language of this bill. Both bills failed to pass out of the house of origin by the constitutional deadline.

SB 169 (Alquist, Stats. 1991, Ch. 117) increased the tax rates on individuals for taxable years beginning on or after January 1, 1991, and before January 1, 1996, by adding 10% and 11% brackets and increasing the AMT rate from 7% to 8.5%.

PROGRAM BACKGROUND

In the early 1990s, California faced a severe recession, which resulted in significant shortfalls in the state budget. In response, the state acted to increase revenues and reduce expenditures. As one way of increasing revenues, the state imposed a temporary income tax rate increase in 1991, adding 10% and 11% rates for the highest income taxpayers. This temporary tax increase was in effect for five taxable years and sunset for taxable years beginning on or after January 1, 1996.

During the November 1996 general election, Proposition 217 was submitted to the voters. Proposition 217 would have extended the income tax increase for higher-income taxpayers and allocated the money from the tax increase to schools and local governments. The proposition was defeated by a margin of 50.8% to 49.2%.

OTHER STATES' INFORMATION

The states surveyed include *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have a personal income tax. *Illinois* and *Michigan* impose a flat tax of 3% and 4%, respectively. *Massachusetts* has a split rate, a flat tax rate of 5.3% for most income and 12% for certain capital gains, dividends, and interest. *Minnesota* has a progressive rate with a maximum tax bracket of \$62,441 and a maximum tax rate of 7.85%. *New York* has a progressive rate with a maximum tax bracket of \$500,000 and a maximum tax rate of 7.7%. These amounts and rates apply to the 2003 taxable year.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains:

Revenue Impact (\$ Billions)				
Fiscal Year	2004-05	2005-06	2006-07	2007-08
Revenue Gain	+\$0.6	+\$3.0	+\$2.6	+\$2.7

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The first fiscal year, 2004-05, includes only a portion of the 2005 tax year impact, since it is assumed that revised employer withholding tables reflecting the new rates would be issued in early 2005.

The tax brackets proposed by this bill were calculated by applying the annual CPI growth to the 1991 tax brackets. The projected 2005 tax brackets for the 10% tax rate would begin at \$142,184 for single, \$284,368 for joint, and \$193,534 for head of household. The projected 2005 tax brackets for the 11% tax rate would begin at \$284,368 for single, \$568,737 for joint, and \$387,068 for head of household.

Approximately 405,000 returns would be subject to the 10% and 11% tax rates in the 2005 taxable year.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1815
As Introduced January 15, 2004

AMENDMENT 1

On page 9, line 18, strikeout "do" and insert:
"does"